**Cashflow Forecasting**

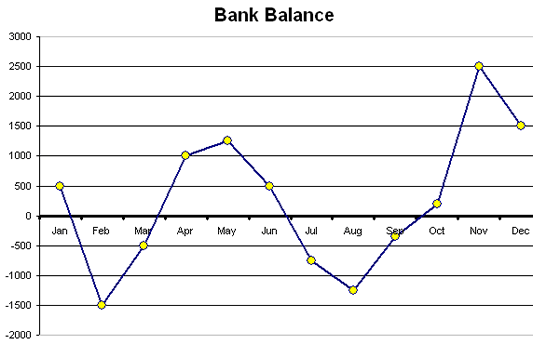
Many business, during the course of a year, will fluctuate between positive and negative bank balances. The chart below depicts a business that has a positive bank balance in January, April, May, June, October, November and December. It also has a negative bank balance in February, March, July, August and September.

So how can a business have a negative bank balance? What does this mean?

The answer is that a business can have a negative bank balance if it has an **Overdraft**. An Overdraft is a facility whereby a bank allows a business to continue to draw funds even when it has exhausted all the funds in its account. In such a situation, where the business's bank account goes below zero, the business is in fact using the bank's money to pay its bills.

Usually a bank imposes an **Overdraft Limit**, that is a limit to how much the business goes below zero in its bank account. If the **overdraft limit is set to $10,000**, then the business must not go beyond a negative $10,000 bank balance.

A bank is in business to make a profit, and so businesses that want to set up an overdraft are usually charged a fee by the bank for this privilege.



The main purpose of cashflow forecasting is to predict what will happen to the bank balance. It is important for a business to know when it is likely to run out of funds in its bank account, and by how much.

If the business knows (by creating a cashflow forecast) when it will run out of funds, arrangements for an overdraft facility can be made in a timely fashion.

Generally, a bank will not create an overdraft facility unless it feels that the business has the capacity to repay the borrowed money.

Therefore the cashflow forecast has two main benefits:

1. It predicts when the business will need an overdraft
2. It helps to assure the bank manager that the business will recover to a positive bank balance.

In the illustration above, the business slips into a negative bank balance at the end of June, but recovers and moves back to a positive bank balance in October.